SUPREME COURT, U.S.
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No. 15-628

IN THE
Supreme Court of the United States

BASSAM YACOUB SALMAN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to
the United States Court of Appeals
for the Ninth Circuit

BRIEF OF OCCUPY THE SEC AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST[1]

Occupy the SEC ("OSEC") is a nonprofit charity with roots in the New York-based Occupy Wall Street movement. OSEC's mission is to advocate for specific improvements to legislation and regulations governing the financial services industry. We seek to ensure that the nation's laws serve the public interest, and not that of Wall Street and its lobbyists. Our group has previously filed amicus curiae briefs in court cases that raise significant issues of concern for financial activists, including the recent Supreme Court cases *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) and *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014).

OSEC submits this brief in support of Respondent and the holding of the Ninth Circuit in the case below, *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015). The instant case centers on a key safeguard against fraudulent insider trading practices: tipper-tippee liability under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j (2006).

Insider trading plagues the securities market today, just as it did a century ago when Justice Brandeis observed that insider positions had become "a happy hunting round for" investment bankers. Louis Brandeis, *Other People's Money and How the Bankers Use It* 13 (1914). "The goose that lays golden eggs has

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[1] The parties have consented to the filing of this brief. The Petitioner has filed a blanket consent to the filing of amicus briefs. A letter from Respondent's counsel consenting to the submission of this brief has been filed with the Clerk of the Court. No counsel for a party authored this brief in whole or in part, and no person, other than *amicus curiae* or its counsel made a monetary contribution to the preparation or submission of this brief.

been considered a most valuable possession. But even more profitable is the privilege of taking the golden eggs laid by somebody else's goose. The investment bankers and their associates now enjoy that privilege." *Id.* at 12.

The exploitation of confidential issuer information by insiders and their tippees continues to plague the securities markets to this day. Empirical evidence reveals that, in the last thirty years, a quarter of mergers and acquisitions involving public companies have suffered from insider trading. Patrick Augustin, M. Brenner, et al., Informed Options Trading Prior to M&A Announcements: Insider Trading? 2 (May 2014), http://bit.ly/2aOnoN1. And forty-five percent of the price increase associated with a merger or takeover occurs before the transaction's announcement to lay investors in the public. William L. Cary & Melvin Eisenberg, *Business Organizations* 944 (11th ed. 2014). The securities markets are rigged in favor of the well-connected and the influential.

This case involves an important legal standard that, if interpreted wrongly, could handcuff the government in its ability to root out such market inequities. OSEC files this amicus to advocate for the interests of lay investors and members of the public at large, whose access to justice will be severely limited if the Court adopts the Petitioner's position. Our governmental system must protect our rights,[2] and we ask the Court to serve the best interests of the people by interpreting Section 10(b) of the Exchange Act in a manner that

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[2] *See* Occupy Wall Street, Declaration of the Occupation of New York City (2011), *available at* http://www.nycga.net/resources/declaration/.

reaffirms that a gift of confidential information from a company insider to a tippee can qualify as a breach of the insider's fiduciary duty to the company. Such an interpretation will protect investors and vindicate the Exchange Act, a central purpose of which was "to insure the maintenance of *fair* and honest markets." 15 U.S.C. § 78b (emphasis added).

SUMMARY OF ARGUMENT

In *Dirks v. SEC*, 463 U.S. 646 (1983), the Court defined tipper-tippee liability, an important aspect of Section 10(b)'s prohibitions on insider trading. Under *Dirks*, a corporate insider at a security issuer breaches his fiduciary duty to the company when he tips a non-insider tippee with confidential company information for trading purposes. *Id.* at 661. In order for the tippee to be liable for trading on the nonpublic information, the insider must have given the information to the tippee for the insider's own "personal benefit." *Id.* at 662.

Dirks established a two-part test to determine when the insider has breached his fiduciary duty by tipping information: a) when the tip is in exchange for some monetary value ("*quid pro quo*"), or b) when the tip is a gift to a trading relative or friend. *Id.* at 664. In *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015), the Second Circuit essentially ignored the second part of the test, and held that only a pecuniary exchange, or a *quid pro quo*, would qualify under the *Dirks* personal benefit test.

That reasoning fallaciously ignored the clear mandate in *Dirks* that an improper purpose is a sufficient basis

for a fiduciary breach. *See Dirks*, 463 U.S. at 659. An insider personally benefits from a tip when he exploits secret company information to enrich himself ***or*** someone of his choosing. *See id.*

Various interpretative principles militate in favor of reaffirming this holding in *Dirks*, without modification. For instance, the *Dirks* standard for tipper liability is not unconstitutionally vague and finds ample support in the breadth of Section 10(b). Also, the Court should reaffirm *Dirks* under *stare decisis.* The Petitioner claims that the rule of lenity supports *Newman*'s constrained view of the personal benefit test. *See* Pet Br. 36, 37. However, lenity does not apply because the Exchange Act was passed with the intention of broadly prohibiting insider trading. Congress has consistently reiterated that intention over the years.

The Petitioner, like *Newman* before him, expresses special solicitude for the selective disclosure of nonpublic information to Wall Street analysts. *See* Pet. Br. 27. He argues that expansive insider trading liability under Section 10(b) hampers the free flow of information. *See id.* at 27, 52. However, his attempts to thusly constrain tipping liability must be rejected because the selective tipping of secret company information flouts congressional intent, hurts the securities markets, and undermines investor confidence.

ARGUMENT

I. THE QUESTION BEFORE THIS COURT HAS BEEN SQUARELY ADDRESSED BY *DIRKS*

A. *Dirks* Endorsed Gift Liability As Part Of Its Two-Part "Personal Benefit" Test

The issue before the Court has already been squarely and forcefully addressed in *Dirks v. SEC*, 463 U.S. 646 (1983). The Court's decision here could begin and end with a parsing of the language of *Dirks* and that case's posture towards gift liability.

In *Dirks*, the court established the circumstances under which a non-insider recipient of confidential company information ("tippee") could be liable for insider trading in violation of Section 10(b). One element[3] in tippee liability is whether the tippee has breached a duty to abstain from trading on nonpublic information. *Id.* at 659-60. Since the tippee's duty

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[3] Another element in establishing tippee liability is showing that the tippee had knowledge ("scienter") that the information was given to him in breach of the insider's fiduciary duty. *Dirks*, 463 U.S. at 660. However, this case is not about scienter, and the Court should reject the attempts of the Petitioner to interpose that separate issue into the body of this case. *See* Pet. Br. 48-52. The Court must "refrain from passing upon the constitutionality of an act of Congress unless obliged to do so in the proper performance of our judicial function, when the question is raised by a party whose interests entitle him to raise it." *Blair v. United States*, 250 U.S. 273, 279 (1919); *see also Yee v. City of Escondido*, 503 U.S. 519, 535 (1992) ("[W]e ordinarily do not consider questions outside those presented in the petition for certiorari.") (citation omitted).

derives from that of the tipper, *id.* at 659, the question of whether a tippee has breached his duty actually turns on whether the insider's tip constituted a breach of the *insider's* fiduciary duty to the company. *Id.* at 661. An insider breaches his fiduciary where he "personally will benefit, directly *or indirectly*, from his disclosure." *Id.* at 662 (emphasis added).

The Second Circuit in *United States v. Newman,* 773 F.3d 438 (2d Cir. 2014), *cert. denied,* 136 S. Ct. 242 (2015) contended that the personal benefit test requires proof of a pecuniary interest. *Id.* at 452 (holding that "in order to form the basis for a fraudulent breach, the personal benefit received in exchange for confidential information must be of some consequence."). However, that contention is belied by the plain words of *Dirks*: "[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a *gift* of confidential information to a trading relative or friend." *Id.* at 664 (emphasis added). *Dirks* used the word "gift" no less than three times in stating its holding. *Id.* at 664, 667. A gift is by definition non-pecuniary in nature. *See Oxford Dictionary of English* 737 (3d ed. 2010) (defining "gift" as "a thing given willingly to someone without payment").

Dirks clarified that a court may infer that an insider has breached his fiduciary duty from objective evidence showing:

> a) a pecuniary "*quid pro quo*" for the tip, or
> b) an intention by the insider to benefit his tippee.
>
> *Id.* at 664.

That is, personal benefit may be shown through either pecuniary or non-pecuniary evidence.

Dirks provides a useful analogy that further elucidates why a non-pecuniary gift by a tipping insider would still qualify as a breach of his fiduciary duty: it would "resemble trading by the insider himself followed by a gift of the profits to the recipient." *Id.* at 664. Had the insider traded himself, he clearly would have "violated his *Cady, Roberts* duty." *Id.* at 663 (referencing *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), which formulates basic insider liability). Whether or not the tippee decided to recompense the insider with a "return gift" as a *quid pro quo* is irrelevant because the insider's breach would have already occurred even before that decision were made.

The Second Circuit in *Newman* lost sight of this crucial aspect of *Dirks*' two-part personal benefit test. By suggesting that the personal benefit test requires an exchange "of some [pecuniary] consequence," 773 F.3d at 452, the Second Circuit erroneously effaced gift liability from the personal benefit formula.

B. Under *Dirks*, An Insider Violates The Personal Benefit Test By Using Secret Company Information to Enrich Himself or His Designee

The gravamen on the personal benefit requirement is that an insider may not exploit secret company information to enrich himself or someone of his choosing. *Dirks*, 463 U.S. at 659 ("Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they also may not give such information to an

outsider for the same improper purpose of exploiting the information for their personal gain."). It makes no difference whether the purpose of the insider's breaching tip is to enrich himself or his designee. Either way, the improper disclosure is being done at the insider's direction and not at that of the company. An insider breaches his fiduciary duty when he exploits insider information for his own reasons (i.e., personal benefit), without the consent of the company.

By reading the personal benefit requirement through this lens, courts need not concern themselves with the nature of the relationship between the tipper and the tippee.[4] Likewise, they need not plumb the depths of the insider's psyche to scour for some "psychic benefit." *See* Pet. Br. 41, 57. Nor need they identify the quantum of benefit actually received by the insider, whether real or ethereal. So long as "objective facts and circumstances" evince that the insider tipped for the purpose of enriching himself or his designee, the inquiry is complete and the inference of fiduciary breach can be made. *See id.* at 664.

This reading of *Dirks* addresses all of the hypothetical challenges raised by Petitioner. For example, the Petitioner notes that Secrist (the insider in *Dirks*) probably obtained some personal satisfaction from exposing the underlying fraud that led to his tips to Dirks (the tippee). Pet. Br. 42. The Petitioner suggests that under the Ninth Circuit's reading of *Dirks*, a reviewing court could have deemed Secrist's personal

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[4] Although a close relationship between the tipper and the tippee could serve as probative objective evidence of the tipper's purposeful exploitation of secret information, it is proof of that improper purpose and not the nature of the relationship *per se* that dictates whether a fiduciary breach has occurred.

satisfaction to meet the personal benefit test for tipping liability. *See id.* However, this reasoning neglects the fact that *Dirks* cabined gift liability to those cases where the *purpose* of the insider's offending tip was to enrich himself or someone of his choosing. *See* 463 U.S. at 659. The objective evidence surveyed by the *Dirks* court revealed that Secrist's tips were not for enrichment but for a different purpose: to expose fraud. *Id.* at 667 ("As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud."). Similarly, accidental tipping would not qualify under a correct reading of the personal benefit test because a truly accidental disclosure would not occur for the purpose of enriching the tipper or his tippee.

The Petitioner requests that the Court afford special consideration to remote tippees as opposed to initial tippees. Pet. Br. 59 ("Section 10(b) should not be applied to remote tippees who do not directly participate in the insider's breach of duty or substantially assist a tippee who does.") However, the number of links in a tipping chain is irrelevant to the issue before the Court: whether an insider's act of tipping equates to a breach of fiduciary duty. It should be noted that other elements of Section 10(b) liability (such as scienter or materiality) may come to the aid of truly remote tippees. *See id.* at 663 n.23 ("Scienter . . . is an independent element of a Rule 10b-5 violation."). Still, those issues are ancillary to the discrete issue being decided here.

C. The Second Circuit's Limitation of the Personal Benefit Standard to Pecuniary Interests Contradicts *Dirks*

The Second Circuit's arbitrary limitation of the personal benefit standard to monetary *quid pro quo* exchanges not only flouts *Dirks,* but also leads to absurd results.

Let us suppose that Maher Kara, the insider in this case, had sold the offending tips to his brother, Michael Kara, in exchange for the pecuniary benefit of $1 million.[5] Presumably both the Petitioner and the Respondent would agree that such an exchange would violate Maher's *Cady, Roberts* fiduciary duty, and would qualify as a pecuniary "personal benefit." Now let us suppose that Maher had exchanged the tips for a derivatives contract that was initially valued at $1 million but ultimately proved to be worthless due to unfavorable market movements. Would the mere fact that Maher ultimately realized no pecuniary benefit absolve him of having breached his fiduciary duty? Under *Newman,* Maher arguably gained nothing "of consequence" and therefore breached no fiduciary duty. Yet common sense dictates that insider trading prohibitions should apply to both profitable *and* unprofitable frauds because the underlying moral culpability is the same under either scenario. *Newman*'s pecuniary "of consequence" test is flawed because it leads to this sort of disparate and illogical result.

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[5] Of course, in actuality there is no dispute that Maher provided the tips for no money. Pet. Br. 5; Resp. Br. 9-10.

This Court recently rejected similarly absurd reasoning in *Bank of America, NA v. Caulkett*, 135 S. Ct. 1995, 2001 (2015). In that case, the petitioner argued that a debtor in Chapter 7 bankruptcy could "strip off" a junior lien if it corresponded to $1 in value, but could not do so if the correspondence was to no value. *Id.* The Court rejected this "odd" reasoning and held that the drawing of such arbitrary lines may be appropriate for Congress, but is not so for the Court. *Id.*

These examples reveal the trouble with attempting to base an insider's fiduciary breach on the quantification of the personal benefit he receives. The virtue of *Dirks*' reasoning was that it deemed an improper purpose to be a sufficient basis for a fiduciary breach. 463 U.S. at 659 ("Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they also may not give such information to an outsider for the *same improper purpose* of exploiting the information for their personal gain.) (emphasis added). To assess whether a fiduciary breach has occurred, a court need only consider the objective evidence pointing to the purpose behind the insider's disclosure, and need not appraise the value of exchange.

The question of whether a gift-giver receives any reciprocal value has plagued philosophers for centuries. *See, e.g.*, Marcel Mauss, *The Gift* 65 (1950) ("Indeed, even in our present legal systems, as in Roman law, here it is not possible to circumvent the most ancient rules of law: there must be a thing or service for there to be a gift, and the thing or service must place [the gift-giver] under an obligation"); *see also* Ayn Rand, *The Virtue of Selfishness* (1964) (arguing that charita-

ble gifts reflect a selfish benefit). *Dirks* wisely instructed courts to eschew these esoteric philosophical questions, and instead focus on objective proof of the purpose of the disclosure. 463 U.S. at 663 ("In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds.").

II. VARIOUS INTERPRETIVE PRINCIPLES STAND IN THE WAY OF PETITIONER'S REQUESTED REMEMDY

The Petitioner and his *amici* posit that various principles of interpretation militate against a broad reading of the personal benefit test. *See, e.g.*, Pet. Br. 35-44; National Association of Criminal Defense Lawyers and the New York Council of Defense Lawyers *Amicus* Br. 14-17. However, those principles do not apply.

A. The Personal Benefit Test Established By *Dirks* is Not Unconstitutionally Vague

Contrary to the Petitioner's assertions, tipping is not a "judge-made" crime. *See* Pet. Br. 60. The tipping crime is actually well-supported by Section 10(b), a catch-all provision that utilizes expansive language to prohibit all types of securities fraud:

> It shall be unlawful for ***any*** person, directly ***or indirectly***, by the use of ***any*** means or instrumentality of interstate commerce or of the mails, or of ***any*** facility of ***any*** national securities exchange—

> (b) To use or employ, in connection with the purchase or sale of ***any*** security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement ***any*** manipulative or deceptive device ***or*** contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary ***or*** appropriate in the public interest ***or*** for the protection of investors.
>
> 15 U.S.C. § 78j (emphases added).

Another provision, 15 U.S.C. § 78t(b), redoubles the force of Section 10(b)'s fraud prohibition by making it unlawful to do indirectly "by means of any other person" any act that is unlawful under the federal securities laws. *See also Dirks*, 463 U.S. at 659 (citing § 78t(b) in support of tipping liability).

The separation of powers principles cited by the Petitioner actually vindicate the *Dirks* court's (and this Court's) authority to delineate the contours of tipping liability within the rubric of Section 10(b) fraud. The Petitioner's approach would unduly hamstring the judiciary's fundamental authority "to say what the law is." *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177 (1803) ("Those who apply the rule to particular cases must, of necessity, expound and interpret that rule."). The *Dirks* court previously said what tipping liability is and it was well within its constitutional authority to do so.

The Petitioner does protest too much about the vagueness of the personal benefit element. The alternative *Newman* standard that the Petitioner champions actually exacerbates any extant vagueness in the tipping regime. Whereas *Dirks* premised tippee liability on the single issue of whether there was an improper purpose behind the tip, 463 U.S. at 659, *Newman* encumbers the inquiry with a host of new elements. Prosecutors need to prove that the exchange is "objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable." *Newman*, 773 F.3d at 452. What is "objective?" What is "consequential?" Does "similarly valuable" mean something that is non-pecuniary? These vague, overbroad terms are neither supported by prior case-law nor contained within the body of Section 10(b). If the Court adopts the *Newman* standard, the judiciary will be forced to wrangle with these vague terms for years to come.

B. *Stare Decisis* Prevents The Dismantling Of Insider Trading Law

The Petitioner's yen for judicial activism goes well beyond supplanting *Dirks* for *Newman*. He even takes the extreme position of advocating for the wholesale dismantling of insider trading law. Pet. Br. 22 ("If the Court were inclined to reconsider its prior cases, it could readily hold, based on the plain language of the statute, that §10(b) does not prohibit insider trading at all"). In one fell swoop, the Petitioner would dismiss decades of case-law shaping criminal liability for insider trading under Section 10(b), and upend the settled expectations of legislators, regulators, market

participants and the public that insider trading will be punished.

Principles of *stare decisis* prohibit such rash action. *See Welch v. Tex. Dep't of Highways & Pub. Transp.*, 483 U.S. 468, 478-79 (1987) ("The rule of law depends in large part on adherence to the doctrine of *stare decisis*."); *see also Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989) ("Considerations of *stare decisis* have special force in the area of statutory interpretation.") Any departure from prior precedent requires special justification. *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984).

The Petitioner has not provided sufficient justification for decriminalizing insider trading. He presents various theories[6] about why insider trading might not fall within the ambit of Section 10(b), but fails to establish the novelty of any of those theories. That is, all of the interpretive arguments raised by the Petitioner in support of repealing *Dirks* could have been (and likely were) considered by the *Dirks* court. In order to overturn *Dirks*, the Petitioner would need to present evidence that circumstances have changed so much that the very criminality of insider trading should be reconsidered. *See Planned Parenthood of Southeastern Pa. v. Casey*, 505 U.S. 833, 864 (1992) ("In constitutional adjudication as elsewhere in life, changed cir-

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[6] For instance, Petitioner cites the text and legislative history of Section 10(b) and the prohibition on judge-made law in support of his request for repeal of *Dirks*. Pet. Br. 22-23. However, the *Dirks* court was certainly well-aware of those issues when it rendered its decision. Similarly, the Petitioner endorses the need for the free flow of information in the securities markets, *id.* at 27, but fails to explain how that need is any more pressing now than it was in 1983.

cumstances may impose new obligations."). No such evidence has been presented.

A century ago Justice Cardozo observed that "[t]he labor of judges would be increased almost to the breaking point if every past decision could be reopened in every case, and one could not lay one's own course of bricks on the secure foundation of the courses laid by others who had gone before him." Benjamin Cardozo, *The Nature of the Judicial Process* 149 (1921). Despite his huffing and puffing, Petitioner cannot blow down the brick-house that is insider trading liability under Section 10(b). That extraordinary remedy is best left for Congress to undertake, should it decide to do so, pursuant to its legislative authority. *See* U.S. Const. Art. I, § 1.

C. The Rule of Lenity Does Not Apply Since Congress Has Repeatedly Endorsed Expansive Insider Trading Liability

The Petitioner and his *amici* argue that the Rule of Lenity favors a restrictive reading of *Dirks*' personal benefit requirement. Pet. Br. 56-57; *see also* Cato Institute *Amicus* Br. 12-16. However, "the rule of lenity only applies if, after considering text, structure, history, and purpose, there remains a grievous ambiguity or uncertainty in the statute such that the Court must simply guess as to what Congress intended." *Maracich v. Spears*, 133 S. Ct. 2191, 2209 (2013) (citations omitted). In this case, there is no grievous ambiguity because Congress has repeatedly placed its imprimatur on an expansive view of insider trading liability.

1. The Exchange Act was passed to broadly prohibit insider trading

"Protection of investors from insiders was one of the chief reasons which led to adoption of the law which the [Securities and Exchange] Commission was selected to administer[:]" the Exchange Act. *SEC v. Chenery Corp.*, 318 U.S. 80, 99 (1943) (Black, J., dissenting). Congress passed the Exchange Act after an investigative commission headed by Ferdinand Pecora unearthed the roots of the Crash of 1929 and the consequent Great Depression, the worst economic crisis in the nation's history. One of the market ills documented by the Pecora Commission was rampant inside trading. *Blau v. Lehman*, 368 U.S. 403, 419 (1962) ("The hearings that led to the Securities Exchange Act of 1934 are replete with episodes showing how insiders exploited for their personal gain 'inside information' which came to them as fiduciaries and was therefore an asset of the entire body of security holders.").

The Exchange Act was passed to extirpate these "predatory operations." S. Rep. No. 1455, 73d Cong., 2d Sess. 68 (1934) ("Pecora Report").

> "Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. *Closely allied to this type of abuse was the unscrupulous employment of in-*

> *side information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.*"
> *Id.* at 55 (emphasis added); *see also* S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934).

Congress intended to flatly prohibit fraudulent trading based on inside information, regarding of whether that trading were done by insiders or by favored outsiders.

Pecora recounted numerous instances of trading syndicates, pools and other collaborations between insiders, outsiders and their affiliates that enabled the exploitation of secret company information by the selected few. *See, e.g.*, Pecora Report 62-63 (reciting, as but one example, the case of Chase National Bank's chairman Albert H. Wiggin, who enriched himself and members of his family through pool operations in Chase Bank stock.) These "predatory operations" bore a remarkable resemblance to the modern day tipping networks that have been the focus of prosecutors' enforcement efforts. *See id.* at 68.

Thus, the Congress that enacted the Exchange Act was very familiar with the concept of insiders tipping secret information to remote parties many links down a tipping chain. The Court may reasonably deduce that Section 10(b), "a catchall clause [designed] to prevent fraudulent practices," *Chiarella v. United States*, 445 U.S. 222, 226 (1980), was crafted to prohibit such predatory behavior.

Of course, the legislative history is silent on the exact mechanism by which an insider's fiduciary duty would

transfer to an outsider tippee, but that mere fact is immaterial. *See Moskal v. United States*, 498 U.S. 103, 111 (1990) ("This Court has never required that every permissible application of a statute be expressly referred to in its legislative history."). The tone and tenor of the legislative reports behind the Exchange Act suggest an orientation towards expansive criminal liability for fraudulent misuse of secret company information. As noted above, Congress utilized broad language to prohibit fraud under Section 10(b), and it adopted Section 20 of the Exchange Act to emphasize that indirect fraud would likewise be punished. 15 U.S.C. §§ 78j, 78t(b).

Congress enacted Section 10(b) to proscribe those "manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S. Rep. 792, 73d Cong., 2d Sess. 6 (1934). The Pecora Report's animadversions against "the unscrupulous employment of inside information" and other market abuses, *see id.* at 55, torpedo any notion that the 1934 Congress would have perceived the exploitation of confidential company information by tippers as serving some useful market function. Even the Petitioner declines to make any argument that Maher's particular tips of confidential information to Michael were "useful" to the markets.[7]

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[7] Indeed, the Petitioner's brief takes great pains to argue that Maher's tips to Michael were procured under duress, thereby painting Maher's tipping as a sort of necessary evil. *See* Pet. Br. 5 ("If anything, Michael bullied Maher into leaking the information").

2. Congress has continued to express preference for an expansive reading of Section 10(b)'s prohibition on insider trading

Both the Second Circuit in *Newman* and the Petitioner have argued that, post-*Dirks*, a watered-down version of the personal benefit requirement has led to excessive insider trading prosecutions. Pet. Br. 45 ("Until *Newman*, the lower courts typically rubber-stamped the government's watered-down version of the personal benefit requirement."); *see also Newman*, 773 F.3d at 448 ("The Government's overreliance on our prior dicta merely highlights the doctrinal novelty of its recent insider trading prosecutions, which are increasingly targeted at remote tippees many levels removed from corporate insiders."). However, the history of Congressional action and non-action since *Dirks* evinces a legislative ratification of expanded insider trading liability.

Since *Dirks* was decided in 1983, Congress has declined to modify Section 10(b) to redress the ostensibly overbroad personal benefit test established in that case. The Court should view this as evidence of Congressional acquiescence towards a robust personal benefit test. To be sure, "courts are slow to attribute significance to the failure of Congress to act on particular legislation." *See, e.g., Aaron v. SEC*, 446 U.S. 680, 694, n.11 (1980). Nevertheless, nonaction is deemed significant where Congress has numerous opportunities to amend a statute, has "acute awareness" of the statute's implications, and yet declines to act. *See Bob Jones Univ. v. United States*, 461 U.S. 574, 600-01 (1983). Those factors are met here.

After *Dirks* was decided, Congress passed two statutes specifically addressing insider trading: the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA"), Pub. L. No. 100-704, 102 Stat. 4677 and the Insider Trading Sanctions Act of 1984 ("ITSA"), Pub. L. No. 98-376, 98 Stat. 1264. Neither statute corrects the putative overbreadth of the personal benefit test.

Congress has also modified Section 10(b) twice since *Dirks*, first in the year 2000 and subsequently in the year 2010. *See* 15 U.S.C. § 78j. Once again, neither modification placed any limits or controls on tippee liability. The 2010 amendment is particularly significant because it was part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. No.111-203, Tit. VII, § 762,124 Stat. 1761, the largest overhaul of the nation's financial laws since the Depression. The Dodd-Frank Act contains a plethora of new laws spanning the entire universe of securities and finance, covering everything from conflict minerals to bank bailouts. Given the breadth of Dodd-Frank, and its focus on various abuses on Wall Street, "Congress — and in this setting, any Member of Congress — [must have been] abundantly aware of" the possibility of insider trading reform. *Bob Jones Univ.*, 461 U.S. at 600-01.

The Dodd-Frank Act expanded Section 10(b) to cover security-based swaps, *see* Resp. Br. 29-30, and also to address fraud in other parts of the financial system. *See, e.g.*, Dodd-Frank Act §§ 929L, 1079A, 1100C. However, not a single provision in that wide-ranging Act corrected the judiciary's supposed rubber-stamping of the government's version of the personal benefit test.

Indeed, Congress has expressed a current antipathy towards *Newman*'s curtailment of the personal benefit test. As of today, three pending Congressional bills would statutorily define insider trading. *See* Ban Insider Trading Act of 2015, H.R. 1173, 114th Cong. (2015); Stop Illegal Insider Trading Act, S. 702, 114th Cong. (2015); Insider Trading Prohibition Act, H.R. 1625, 114th Cong. (2015). All three of them were passed in opposition to the *Newman* decision's restrictive interpretation of the personal benefit test. *See* Bruce W. Klaw, *Why Now is the Time to Statutorily Ban Insider Trading Under the Equality of Access Theory*, 7 Wm. & Mary Bus. L. Rev. 275, 338, 342, 343 (2016) ("Klaw"). At least one of the bills, The Ban Insider Trading Act of 2015, would abandon the personal benefit requirement altogether and impose in its stead a blanket prohibition on trading on any material information that was not procured through due diligence from a publicly available source.[8] In sharp contrast, there are exactly zero pending bills that vindicate *Newman* or otherwise reduce the scope of insider trading liability.

III. THE SELECTIVE TIPPING OF SECRET COMPANY INFORMATION IS CONTRARY TO CONGRESSIONAL INTENT AND ECONOMIC EFFICIENCY

While much of academia has criticized the Second Circuit over its *Newman* decision, *see, e.g.*, Klaw at 279 ("the *Newman* case unjustifiably impedes the govern-

[8] S. 702.

ment's ability to restrain and punish tippers and tippees") (citation omitted), concern over *Newman*'s vague, overbroad terms is not purely academic. In the short time since its issuance, the *Newman* decision has been read as a veritable "Get Out of Jail Free" card for insiders and their tippees. Numerous defendants across the country (including the Petitioner) have sought to overturn their insider trading convictions or settlements under the *Newman* standard. *See, e.g.*, *United States v. Riley*, 2016 WL 158464 (2d Cir. Jan. 14, 2016). The government has even tamped down its enforcement of insider trading because of perceptions that *Newman* has made insider trading more difficult to prosecute. *See* Michael Bobelian, *As Preet Bharara Drops Seven Insider Trading Charges, Some Enforcement Might Move Out Of New York*, Forbes, Oct. 23, 2015. The *Newman* decision has sent a strong signal to would-be fraudsters that insider trading will increasingly go unpunished.

The Petitioner suggests that even if the *Newman* standard were to lead to fewer prosecutions for insider trading, that outcome would help the markets by promoting the "legitimate exchange of information." *See* Pet Br. 27. The Petitioner cites dicta in *Dirks* for the proposition that the selective tipping of inside information to information analysts plays a salutary role in the proliferation of investment news.[9] However,

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[9] *See Dirks*, 463 U.S. at 658 (noting with favor that analysts commonly meet with corporate insiders privately to "ferret out and analyze information"). The Court has consistently held that there is no general duty between all participants in market transactions to forgo actions based on material, nonpublic information. *Chiarella*, 445 U.S. at 233. That is, the average person with no connection to a security issuer has no presumed obligation to

that proposition finds no support in the Exchange Act's legislative history. The reality is that the selective disclosure of inside information to analysts hurts the markets and undermines investor confidence.

A. The Selective Tipping of Inside Information to Financial Analysts is Contrary to Congressional Intent

Congress has never espoused the position that the Exchange Act permits the selective disclosure of material, nonpublic information to financial analysts at the exclusion of the investing public at large. Instead, Congress' pronouncements on market disclosure have consistently reiterated the need for fairness and parity. For instance, in 1975, several years before the *Dirks* decision, Congress confirmed that:

> [t]he basic goals of the Exchange Act remain salutary and unchallenged: To provide fair and honest mechanisms for the pricing of securities, to assure that dealing in securities **is fair and without undue preference** or advantages among investors * * * and to provide, **to the maximum degree practicable**, markets that are open and orderly.
> H.R. Rep. No. 229, 94th Cong., 1st Sess. 91-92 (1975). (emphasis added).

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forgo trading on secret company information. *See id.* However, different rules apply for the insider, who necessarily owes a fiduciary duty to an issuer. Such insiders are not permitted to selectively tip off their relatives or friends with nonpublic information for trading purposes. *Dirks*, 463 U.S. at 664.

This proclamation expresses a fixed aversion to the selective disclosure of inside information. Never has Congress intimated that the preferential disclosure of market information to Wall Street analysts is "due." *See id.*

Indeed, to whatever extent *Dirks* can be read to endorse the right of privileged Wall Street analysts to enjoy the fruits of selective disclosure, that endorsement was at odds with the contemporaneous wishes of Congress. In 1983, the very year that *Dirks* was decided, Congress recognized that the investing public had a "legitimate expectation of honest and fair securities markets where all participants play by the same rules." H.R. Rep. No. 355, 98th Cong., 1st Sess. 5 (1983) (expressing the legislative intent behind the ITSA). Shortly thereafter, the legislative report for the ITSFEA made the common sense observation that, "small investors will be . . . reluctant to invest in the market if they feel it will be rigged against them." H.R. Rep. No. 910, 100th Cong., 2d Sess. 8 (1988). The Exchange Act was passed to protect all investors, and not just influential Wall Street analysts.

B. The Selective Disclosure of Company Information to Analysts Rigs the Markets Against Investors and is Economically Inefficient

In the decision below, Judge Rakoff sagely observed that the Petitioner's reading of the personal benefit standard would allow a corporate insider to disclose proprietary information to any third party for trading purposes, free of criminal liability, so long as the in-

sider received no tangible benefit in return. *See Salman*, 792 F.3d at 1094. The markets can only suffer from that kind of cronyism.

Most of the government's recent prosecutions for unlawful tipping have involved company insiders selectively disclosing confidential information to professional financial analysts and their associates. *See, e.g., Newman*, 773 F. 3d at 488. This phenomenon of selective disclosure to the privileged few hurts the markets in a variety of ways. For one thing, trading on inside information ahead of the market can skew natural price trends. For instance, suppose a well-heeled institutional investor is tipped off by company insiders that the company is about to report weaker-than-expected earnings. Exploiting that information, the institutional investor executes a large block-trade to short the stock, betting that the price will fall. The trading public, taking special notice of the size of the institutional investor's short sale, panics, thereby setting off a fire-sale that causes the stock price to plummet well below the true market price. In such a scenario, the selective disclosure will have enriched the institutional investor, impoverished non-insider shareholders, and produced inefficient market pricing. Had the company disclosed the negative information to all investors at the same time, it would have been able to "put reassuring contingency plans in place" to buffer the impact of that information. *See* Klaw at 326.

The selective disclosure of company information to the Petitioner's contacts – be they friends, relatives, fellow church-goers or former classmates – also allows those privileged contacts to extract wealth from the marketplace. That type of disclosure is *criminal* because the extracted wealth properly belongs to inves-

tors en masse. Such profiteering erodes public confidence in the securities market and serves "no useful function." *See* S. Rep. 792, 73d Cong., 2d Sess. 6. A market that permits Wall Street analysts to enjoy informational advantages creates incentives for disadvantaged investors to engage in corrupt actions to overcome their disadvantage. *See United States v. O'hagan*, 521 U.S. 642, 658 (1997) (citation omitted). Some investors will be pushed to refrain from trading altogether. *Id.* For example, research shows that household stock market participation decreases following corporate scandals in the state where the household resides. Mariassunta Giannetti & Tracy Yue Wang, *Corporate Scandals and Household Stock Market Participation* 2 (2015), http://bit.ly/2aZdr0x. Such decreased participation is directly due to a loss of trust in the market. *See id.*

Congress passed the ITSFEA and the ITSA out of concern that insider trading impairs capital formation and debilitates investor confidence. *See* H.R. Rep. No. 355, 98th Cong., 1st Sess. 2; H.R. Rep. No. 910, 100th Cong., 2d Sess. 8; *see also* 129 Cong. Rec. S3865 (daily ed. Mar. 23, 1983) (remarks of Sen. D'Amato); 130 Cong. Rec. H7759 (daily ed. July 25, 1984) (remarks of Rep. Wirth). Empirical research shows that Congress was correct to be thusly concerned. A survey of insider trading enforcement in 103 countries shows that lax insider trading enforcement worldwide reduced market liquidity and increased the cost of participating in the stock market by up to 7 percent. Utpal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. Fin. 75, 78 (Feb. 2002); *see also* Laura N. Beny, *Do Investors in Controlled Firms Value Insider Trading Laws? International Evidence*, 4 J. L. Econ. & Pol'y

267, 267 (2008) (demonstrating that stringent insider trading law is associated with great corporate valuations); Art A. Durnev & Amrita S. Nain, *Does Insider Trading Regulation Deter Private Information Trading? International Evidence*, 15 Pac. Basin Fin. J. 409, 411 (2007) (same). Lack of investor trust in the market increases the risk premiums that investors demand to participate in the market. These higher transaction costs can negatively impact a country's overall economy and credit rating. *See* Bhattacharya & Daouk 101-02; *see also United States v. Naftalin*, 441 U.S. 768, 776 (1979) ("frauds perpetrated upon . . . investors can redound to the detriment of the . . . economy as a whole.").

The selective disclosure of confidential information particularly disadvantages retail investors. No amount of due diligence will allow the lay investor to gain access to the privileged market information that is routinely made available by insiders to their institutional tipping networks. "Even supporters of legalized insider trading have noted that insider traders often obtain this 'secret' information through 'the good old boy network.'" Klaw at 307. A retail investor cannot simply contact a corporate executive and acquire insider information the way that Wall Street analysts can. As a result, the retail investor is forced to compete in the marketplace for securities with one hand tied behind his back. The framers of the Exchange Act discovered that the stock market was rigged in favor of big players, and passed the Act with the intention of correcting that problem. The Petitioner and *Newman* advance a position that flouts those framers' Congressional intent.

Thirty years ago, *Dirks* expressed solicitude for the democratizing role that Wall Street analysts can play in proliferating market information. *Dirks*, 463 U.S. at 658-59. It premised that solicitude on the assumption that alternate means of information proliferation were not available. *Id.* at 659 ("It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.") (emphasis added). However, the advent of the World Wide Web in the thirty years since *Dirks* undermines that central premise. Today, corporations can instantly broadcast information to the entire marketplace at zero marginal cost. To whatever extent *Dirks* endorsed the right of analysts to preferentially utilize inside information, that endorsement lacks validity due to changed technological circumstances. *See Casey*, 505 U.S. at 864 ("In constitutional adjudication as elsewhere in life, changed circumstances may impose new obligations").

One must recall that when Wall Street analysts "ferret out" company information, *Dirks*, 463 U.S. at 658, they do so for purely monetary gain, and not for the purpose of disseminating information in the way that journalists publicize hidden facts into the public domain. Defendant Chiasson in the *Newman* case was able to "ferret out" confidential information about Dell and Nvidia to the tune of $68 million. *Newman*, 773 F.3d at 443. The Second Circuit ultimately absolved Chiasson, but nonetheless failed to consider whether the "entire body of security holders," *Blau*, 368 U.S. at 419, laid any superior claim to those $68 million in profits.

The Court should reject the Petitioner's narrow reading of the personal benefit standard because that reading would benefit the privileged few while inuring to the disadvantage of the investing public at large.

CONCLUSION

For the foregoing reasons, *amicus curiae* urges the Court to rule in favor of the Respondent and hold that that Section 10(b) prohibits an insider from exploiting secret company information to enrich himself or his designee, regardless of the identity of the designee or the extent of benefit received by the insider in exchange for the information.

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